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Presentation by Morgan Stanley Technical Conference, PJM Interconnection's Reliability Pricing Model

Unencumbered Energy Pricing & Forward Contracting Requirements

February 3, 2006

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PJM Administers A Model Energy Market

- It is self evident that PJM has created the pre-eminent electric market world wide
- PJM has done many things well
- This presentation will focus only on Morgan Stanley's concerns regarding, and alternatives to, the proposed Reliability Pricing Model ("RPM")

Necessary Goals

Goals for PJM market structure:

- Attract and sustain needed capacity
- Protect buyers from extreme price volatility
- Provide reliable service at the lowest cost

ICAP-Like Market Designs Are Not The Answer

ICAP structures do not:

- Provide confidence to investors that consistent revenue streams exist
- Promote or require long-term contracting or hedging by LSEs
- Foster the right mix of investments in the right locations
- produce efficient outcomes
- Reflect wide disparities of the Value of Lost Load, or provide the correct price signals for load response
- Allow customers to exercise choice in reliability level and cost
- Represent market-based solutions, or let the market work
- Provide reliable electric service at the lowest cost



ICAP-Like Market Designs Are Not The Answer

ICAP structures do:

- Distort price signals
- Create higher prices due to insufficient or uneconomic investment
- Create revenue streams perceived as being strongly influenced by regulation, and highly vulnerable to regulatory whim
- Require administrative central planning reminiscent of cost-of-service regulation
- Re-introduce the potential for stranded costs
- Require a regulatory process to determine the type, amount, location, and characteristics of capacity - the failed regulatory model all over again - a slippery slope to re-regulation



A Market Design Combining Unencumbered Spot Prices and Mandated Forward Contracting Requirements Is The Answer

- Combination of Unencumbered Spot Energy Prices and Mandated Forward Contracts
 - Efficient, lets the market work
 - Accurate price signals recognizes vital role of price volatility in an efficient market, and provides price stability through forward contracts for those who need it
 - Brings about optimal investment level, mix, and locations
 - Properly values and therefore maximizes demand response participation
 - Enables producers and consumers to determine desired mix of exposure to volatile market prices VS stable long-term contract prices
 - Creates a liquid and transparent long-term forward market that reduces risk for investors in new plant
 - Provides necessary revenue streams to attract and sustain necessary investment
 - Greatly simplifies (but does not eliminate) regulatory processes
 - Fosters long term forward market development
 - Similar constructs have been implemented in Australia, the UK, and Alberta and [are being considered in MISO and ERCOT verify]



The Choice Is Simple

- Continue to advance pre-eminent market-based structure using market principles; OR
- Start to move backwards, in the direction of regulatory central planning